This record is a partial extract of the original cable. The full text of the original cable is not available.

C O N F I D E N T I A L SECTION 01 OF 03 THE HAGUE 002733

SIPDIS

E.O. 12958: DECL: 10/28/2013
TAGS: EAIR EU NL
SUBJECT: KLM CEO SAYS 'BREAKTHROUGH' MERGER TO SPUR MORE CONSOLIDATION; EXPECTS UK TO STALL U.S.-EU TALKS

REF: SECSTATE 299649

Classified By: AMBASSADOR. REASONS 1.5(B) AND (D)

Summary

¶1. (C) KLM's "breakthrough" merger with Air France sets a precedent that will spur further consolidation within the airline industry, KLM President and CEO Leo van Wijk told the Ambassador in an October 9 meeting. Van Wijk likened the pact to the Netherlands' first-ever Open Skies agreement with the U.S., which also set a pattern for other such arrangements. Van Wijk commented that the British would try to stall or block a US-EU Open Skies deal as long as possible to preserve BA's competitive edge at Heathrow. He reported that the AF-KLM deal was greatly facilitated by the fundamental economic logic of the arrangement, since Air France would have been at a severe competitive disadvantage had KLM chosen to link up with either BA in oneworld or Lufthansa in the Star Alliance. As it is, the deal will preserve the most even competitive balance among the three principal alliances, since joining the KLM-Northwest-Continental group's nine percent market share to Skyteam's 12 will nearly match the Star Alliance's 22 percent and oneworld's 17. The British, who could have merged with KLM years ago, appear to have chosen to preserve the status quo, especially regarding slot allocation at Heathrow, currently not served by either Northwest or Continental. Van Wijk did not expect US regulatory opposition to the merger. Regarding the antitrust implications of a link-up of Northwest and Continental with Delta in Skyteam, he counseled that, with six principal international US carriers and only three alliances for them to join, the choice is between allowing such cooperation or potentially forcing the weaker carriers into bankruptcy.

End summary.

French understanding of GoNL concerns
-- ------------------

¶2. (C) In an hour-long discussion October 9, KLM President and CEO Leo van Wijk told the Ambassador that he was very satisfied with the deal with Air France announced September 30, which succeeded despite some last-minute issues thrown into the negotiations by the GoNL. Although this caused some embarrassment, it did not prove to be a fundamental obstacle, as the French were relatively understanding of such state concerns. Despite some media commentary to the effect that Air France had overpaid for the deal, said van Wijk, in reality the agreement had been facilitated by the fundamental economic logic behind the merger. (Note: according to the KLM-Air France press release, the deal values KLM stock at EUR 16.74, or a 40 percent premium over its September 29 level and at a 77 percent premium calculated on the basis of the average share prices of KLM and AF over the previous three months. End note.) Had KLM chosen to link up with either BA or Lufthansa, AF's competitive position would have been significantly disadvantaged; the French thus had a strong incentive to wrap up KLM for themselves, creating Europe's largest carrier in the process.

¶3. (U) Note: the Air France-KLM merger, which was signed October 16 but still requires regulatory approval, creates a new holding company which will own and run the two airlines as separate operating companies. KLM will have 19 percent of the shares in the new holding company, with the French portion divided between the GOF (44 percent) and other AF shareholders (37 percent). To preserve KLM's international landing rights, 51 percent of the voting rights in the KLM operating company will be held by two Dutch foundations and the GoNL for a transition period of three years. End note.

Competitive implications

¶4. (C) As it turns out, continued van Wijk, the AF-KLM merger will create a more balanced competitive situation than had KLM merged with either BA or Lufthansa. With the

addition of KLM, Northwest, and Continental, Skyteam's market share will rise to 21 percent, just short of the Star Alliance's 22 percent and ahead of oneworld's 17. That should allay US regulatory concerns about the linkup of Northwest and Continental with Delta in Skyteam. In fact, he argued, with six major US international carriers (American, United, Delta, Northwest, Continental, and USAir) and only three alliances for them to choose from, the options for the US authorities were to allow such intra-alliance cooperation or to face the possible bankruptcy of excluded carriers. Van Wijk reported that he had discussed the possible merger with Air France with USDOT some months ago and encountered no fundamental opposition, provided that such cross-border mergers were done between the national carriers of countries with which the US has Open Skies agreements (i.e., excluding the UK).

UK to stall US-EU talks?

¶5. (C) Thus far, said van Wijk, the reaction from both BA and Lufthansa had been complete silence. While KLM had engaged in merger discussions with BA several years ago, the deal was not concluded because BA evidently felt that gaining regulatory approval for such a merger could have upset the status quo at Heathrow. BA's preference for the status quo led van Wijk to expect that the UK would be a delaying force in the current US-EU civair negotiations. Although the UK also had to consider the interests of Virgin and British Midland (which cooperates with Lufthansa and has ordered long-range aircraft to fly transatlantic routes out of Heathrow), van Wijk said, the Brits would probably try to delay or block agreement by, for example, pushing for intra-US service rights or increases in the cap on foreign ownership of US carriers. European carriers were really not interested in serving the US domestic market, in light of their codeshare arrangements, thought van Wijk. But pushing for reciprocal intra-domestic rights, which had some resonance among members of the European Parliament, could be an effective delaying tactic, he thought. As the only EU country without an Open Skies agreement, the UK would have extra influence with Commission negotiators, he added.

Preserving KLM and Schiphol
-- ---

¶6. (C) Van Wijk was pleased that the merger with Air France would preserve KLM's corporate identity, at least for an initial transition period, and would also preserve the position of Schiphol, Europe's 4th-busiest airport, as an important international hub. The terms of the deal called for both Schiphol and Charles de Gaulle to be operated as co-equal hubs of the merged company, and for adjustments in service to be implemented proportionately. The agreement also specified 35 long-range routes that would continue to be serviced from Schiphol, at least initially; any decision to cut such services would have to be taken jointly.

More mergers to come?

¶7. (C) Van Wijk also thought that the deal would clear the way for other, similar deals involving the smaller and weaker European carriers, which, he implied, were not viable as independent entities in the long run. He also thought that such mergers would increase pressure to revise or reform the 1944 Chicago Convention governing landing rights, since in a world of steady consolidation of carriers across national borders, the current system of granting landing rights on a binational basis would become increasingly unworkable.

No pressure to buy Airbus

¶8. (C) In response to the Ambassador's question about the effect of the merger on KLM's fleet, van Wijk said that KLM would not be pressed to replace its current aircraft with Airbus equipment. KLM was taking delivery of some 10-20 new Boeing 777 aircraft over the next few years and would stay with 737s for its regional operations. There was no economic sense in trying to combine or replace those aircraft with Air France's all-Airbus short-range fleet.

Security concerns

¶9. (C) On security issues, van Wijk said that his major concern was the impact of increased screening on the rapid and efficient flow of air cargo, which could have a significant effect on business supply chains. On PNR, he said that, although KLM is continuing to cooperate with the US, it would eventually have to comply with whatever stance the EU takes. He also raised the competitive impact of

security measures, arguing that USG compensation to US carriers for security-related costs would have negative competitive implications for non-US carriers.

COMMENT

¶10. (C) We have reported van Wijk's comments at length because we believe him to be particularly well-positioned to offer insights into the current state of play among the major national carriers in Europe, as well as how their interests might shape the current US-EU civair talks. Embassy would appreciate any similar commentary that other posts might pick up.

SOBEL